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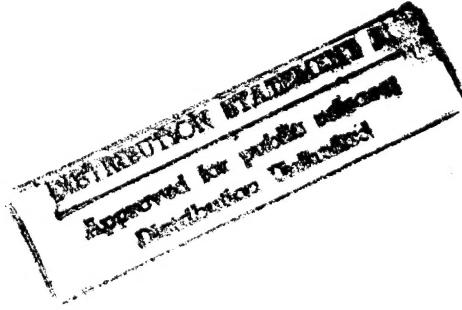
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DEFENSE PROGRAMS
AND SPENDING

Need for Reforms

Statement of Frank C. Conahan, Senior Defense and
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United States



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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss defense programs and spending. As the Congress seeks to reconcile the nation's defense needs with other national priorities, you face the difficult challenge of recommending the size of the defense budget. While the debate continues on the appropriate top line for defense spending, Mr. Chairman, you and others have made it clear that further actions must be taken to make defense programs more cost-effective and efficient.

As you know, the Department of Defense (DOD) has taken significant steps toward downsizing the defense structure and budget. In the past 10 years, the number of men and women in uniform has declined by 28 percent and a significant number of Army divisions, Air Force wings, and Navy ships have been removed from the active force. During the same period, the defense budget has dipped from \$391 billion to \$252 billion in constant 1995 dollars--a reduction of 35 percent.

While transitioning to a downsized structure and budget, DOD has not fully analyzed certain assumptions underlying its new force structure and some assumptions are questionable; roles and functions of the military services remain to be sorted out; and a substantial mismatch between programs and funding continues. Our work clearly shows that DOD wastes billions of dollars each year because of long-standing inefficiencies in its day-to-day operations and because it has been slow to take advantage of opportunities to reform systems and processes, make further reductions in infrastructure, and reduce costs.

FACTORS UNDERLYING DEFENSE SPENDING

Let me first discuss some factors that underlie defense spending, and have been subject to question. These relate to the basis for defense planning and spending--the bottom-up review, overlapping roles and functions, and the mismatch between programming and funding.

Bottom-Up Review

In the Report on the Bottom-Up Review (BUR), the Secretary of Defense laid out the forces that DOD believes it needs to fight and win two nearly simultaneous major regional conflicts and at the same time meet commitments to provide a presence overseas and conduct smaller scale operations. The Secretary also identified specific enhancements needed to bolster force capabilities, like improvements in strategic mobility and the lethality of U.S.

firepower. In our January 1995 report,¹ we concluded that, in sizing the force for the two-conflict strategy, DOD did not fully analyze key BUR assumptions and some of DOD's assumptions are questionable.

Prompted by concern about the BUR results, the Congress mandated that DOD reexamine the BUR's assumptions and conclusions about force and budgetary needs and report on the review to the President and Congress in May 1995.

Roles and Functions

For a long time, we have been hearing about overlapping and duplicative roles and functions of U.S. forces. The Goldwater-Nichols Act of 1986 directed the Chairman of the Joint Chiefs of Staff to review the roles and functions of the services not less than every 3 years and report needed changes. The Chairman's first report, issued in 1989, did not do the job. And although the second report, issued in 1993, identified some important opportunities for change and went beyond the first study, it did not recommend significant reductions in overlapping functions. In a July 1993 report,² we identified additional opportunities to address overlapping capabilities and improve the efficiency of the armed forces. Our current evaluations of specific mission areas such as close support, interdiction, and air superiority are likely to identify additional opportunities to reduce unnecessary duplication and achieve cost-efficiencies.

The Congress recognized that the Goldwater-Nichols mandate did not produce the comprehensive review it envisioned and established an independent commission to review, evaluate, and report on the roles, missions, and functions of the forces. The commission is required to issue its report by May 1995.

Mismatch Between Defense Programs and Funding

As you know, we reported in July 1994 that the 1995-99 Future Years Defense Program had too many programs for the available dollars.³ This is not a new problem. Since the mid-1980s, we have been reporting that DOD employs a systemic bias toward overly optimistic planning assumptions. This bias has led to program instability, costly program stretch-outs, and program

¹Bottom-Up Review: Analysis of Key DOD Assumptions, (GAO/NSIAD-95-56, Jan. 31, 1995).

²Roles and Functions: Assessment of the Chairman of the Joint Chiefs of Staff Report (GAO/NSIAD-93-200, July 15, 1993).

³Future Years Defense Program: Optimistic Estimates Lead to Billions in Overprogramming (GAO/NSIAD-94-210, July 29, 1994).

terminations. We believe such unrealistic planning provides an unclear picture of defense priorities because tough decisions and trade-offs are avoided. Instead, program decisions end up being made on a piecemeal basis to meet each year's funding realities.

In our July 1994 report, we estimated that the mismatch between programming and funding in the 1995-99 Future Years Defense Program could exceed \$150 billion. Others have developed varying estimates of the magnitude of the mismatch, but there is general agreement that a mismatch exists. Since our report, the administration and DOD have taken actions that should correct some of the imbalance. For example, the President said he plans to provide an additional \$25 billion for DOD's budget--\$10 billion would apply to 1995-99. Also, DOD announced that it will stretch out, reduce, or terminate seven major programs, thereby reducing funding requirements by about \$8 billion through the year 2001.

DAY-TO-DAY OPERATIONS WHERE SUBSTANTIAL SAVINGS CAN BE ACHIEVED

Last month, as part of our continuing effort to help the Congress identify ways to reduce the deficit, we reported on 120 options for reducing spending or increasing revenues in federal services and programs.⁴ About 30 of these options relate to national defense, covering the spectrum of defense programs. Specific options include reconsidering the need to acquire certain weapons systems or delaying their acquisition, improving inventory and financial management, and using commercial practices for supplying defense needs. I would like to briefly discuss a few areas where substantial savings are possible. These areas are defense acquisition, military installations, inventory management, the industrial base, and financial management.

Defense Acquisition

DOD is the largest buying organization in the world, spending about \$80 billion annually to research, develop, and procure weapon systems. While DOD has produced many highly capable weapons systems, there is widespread agreement--in DOD, the defense industry, and the Congress--that opportunities must be found to reform defense acquisition. DOD's process for determining weapons systems requirements and acquiring systems often proves costly and inefficient, if not wasteful. DOD weapons acquisitions frequently experience cost overruns, schedule delays, and performance shortfalls. For example, we have reported that cost increases of 20 to 40 percent have been

⁴Addressing the Deficit: Budgetary Implications of Selected GAO Work for Fiscal Year 1996 (GAO/OCG-95-2, Mar. 15, 1995).

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common for major weapons programs and that numerous programs have experienced increases greater than that.⁵

Last year, the Congress enacted the Federal Acquisition Streamlining Act to simplify the laws governing federal contracting. The act, among other things, calls for simplified contracting procedures for certain procurements, greater reliance on commercial items, and electronic commerce to facilitate buying goods and services. We strongly supported the legislation and believe it is a significant step toward reform. However, it is only a beginning. Much more needs to be done--particularly in the way DOD manages its multi-billion dollar weapons acquisition programs.

Over the years, we have reported on the persistent problems that have plagued weapons acquisition. Despite past and current efforts to reform the acquisition system, wasteful practices still add billions of dollars to defense acquisition costs. Many new weapons cost more, are less capable than anticipated and experience schedule delays. Moreover, the need for some of these costly weapons is questionable, particularly since the collapse of the Soviet Union. These problems are typical of DOD's history of inadequate requirements determinations for weapon systems; projecting unrealistic cost, schedule, and performance estimates; developing and producing weapons concurrently; and committing weapons systems to production before adequate testing has been completed.

It has almost become a cliche to state that the numerous reforms initiated over the years have not had the desired effect and that today we face the same array of acquisition problems. The success of "reforms"--defined in the larger sense by laws, DOD regulations, and recommendations from outside panels and independent organizations--has been limited, not because these reforms embodied bad ideas or focused on the wrong issues. They simply did not go far enough.

For changes in weapons acquisition to be lasting, we believe acquisition problems need to be looked at from another perspective--as the consequence of a way of acquiring weapons that has become deeply rooted through the years. We refer to this as the "culture", although this is a somewhat imprecise term. Rather than defining culture as mindsets and attitudes, we use the term to describe (1) the collective patterns of behavior exhibited by the numerous participants in the acquisition process and (2) the incentives for that behavior. These participants include various components of DOD, the Congress, the defense industry, and others.

⁵Future Years Defense Program: Optimistic Estimates Lead to Billions in Overprogramming (GAO/NSIAD-94-210, July 29, 1994).

The culture has evolved as the acquisition process has become a vehicle for meeting the diverse needs of participants through the steady initiation and sustainment of weapon programs. These needs, as translated into weapon systems, transcend the filling of voids in military capability at minimum cost; they involve the definition of roles and functions, the justification of budget levels and shares, service reputations, organizational influence, the industrial base, jobs, and careers.

Shrinking budgets, dwindling forces, and expanding missions should make the participants in the acquisition process more receptive to change than they have been in the past. As the Secretary of Defense has stated, "reform is no longer desirable, it is imperative." However, if meaningful and lasting reform is to be achieved in defense acquisition, the culture must be addressed.

In recent months, a number of proposals have been advanced to reform defense acquisition, including the Department of Defense Acquisition Management Reform Act of 1995 introduced last month in both the House and Senate. Each of these proposals contain features attempting to deal with the cultural issues that have stymied past reform initiatives. Each proposal deserves serious attention and consideration.

Having said that, I think it is very important to caution you about the need for careful and proper implementation of any reforms to avoid problems that DOD has experienced in implementing other significant changes in its operations. DOD's Corporate Information Management initiative--to reengineer common business processes across DOD--is a case in point. As we testified last month, this initiative, introduced about 5 years ago, has yielded marginal results to date.⁶ The Defense Business Operations Fund--a broad sweeping change implemented in 1991 to improve financial management--is another example. For reasons I will discuss later in my testimony, DOD has been unable to properly manage this operation.

Military Installations

DOD anticipates that the realignment and closure of unneeded military bases and facilities resulting from the four rounds of closures between 1988 and this year will result in substantial savings--a total of about \$6 billion in recurring annual savings. Although the first three rounds recommended fully or partially closing 70 major domestic bases and closing, realigning or otherwise downsizing scores of other bases, additional opportunities have not been fully realized. As we reported this

⁶Defense Infrastructure: Enhancing Performance Through Better Business Practices (GAO/T-NSIAD/AIMD-95-126, Mar. 23, 1995).

month,⁷ DOD, in its recommendations for the 1995 round, proposed to eliminate some excess capacity and infrastructure, but much remains. To bring base infrastructure in line with reductions in force structure, DOD's goal for the 1995 round was to reduce the overall domestic base structure by at least 15 percent--an amount at least equal to the reductions in the three previous rounds. However, DOD's 1995 recommendations are projected to reduce the infrastructure by only 7 percent.

The Chairman of the Joint Chiefs of Staff, citing opportunities for the services to jointly use bases and training facilities, testified that excess capacity remains and that future base closure authority will be needed. The Secretary of Defense recently stated that excess infrastructure will remain after the 1995 round and suggested the need for additional rounds in 3 to 4 years, after DOD has absorbed the effects of recommended realignment and closures to date. However, the current authority for the realignment and closure process expires after the 1995 round. Should further reductions be sought, some process will be needed.

Let me refer to DOD's depot maintenance structure to illustrate a key area where DOD did not take full advantage of the 1995 round to reduce excess capacity. The Office of the Secretary of Defense (OSD) identified 40.1 million direct labor hours of excess capacity. Even if the services' 1995 recommendations for realigning depot activities are accepted, the excess capacity remaining will be equivalent to several average-sized depots.

To illustrate, the Navy's recommendations would reduce its 5 million direct labor hours of excess capacity in aviation depots by only 670,000 hours, less than 14 percent. Further, the Navy did not take advantage of opportunities to move some of its aviation workload to other services' depots and did not propose reducing excess capacity in its nuclear shipyards. OSD estimated that the Air Force, which recommended no depots for closure, has excess capacity of 13.2 million direct labor hours. We estimate that savings associated with four potential depot closures identified by OSD would yield long-term savings of about \$3.5 billion dollars.

We have also reported that DOD should improve its processes for allocating depot maintenance workload between the public and private sector.⁸ As you know, DOD is limited in its ability to establish the most efficient public-private mix because 10 U.S.C.

⁷Military Bases: Analysis of DOD's 1995 Process and Recommendations for Closure and Realignment (GAO/NSIAD-95-133, April 14, 1995).

⁸Depot Maintenance: Issues in Allocating Workload Between the Public and Sectors (GAO/T-NSIAD-94-161), April 12, 1994.

2466 prohibits the military departments from contracting out more than 40 percent of their respective depot maintenance workload. The proposed Defense Acquisition Management Reform Act of 1995, calls for eliminating this restriction and establishes a policy of utilizing the private sector to perform depot level maintenance work whenever possible. We have previously reported that Congress may wish to consider eliminating the 60/40 requirement and providing that DOD assign depot work on the basis of merit criteria that include industrial base, readiness, and core requirements as well as cost.

Inventory Management

Inventory management is an area where DOD has experienced long-standing problems in managing its resources. While we have seen some improvements over the past several years, DOD wastes billions of dollars buying, maintaining, and storing supplies that become excess. Notwithstanding the sizable force structure changes in recent years, DOD's inventory funding levels remained constant with the military services spending about \$25 billion annually. However, our work shows that much of this spending may be unnecessary. For example, as of September 1993, about \$1.7 billion of the \$9 billion of inventory that DOD was buying at that time was not needed to meet war reserve or operational requirements. Along the same line, last year, we and the Air Force identified over \$209 million in invalid back orders at 17 retail activities⁹. (The Air Force subsequently cancelled these orders.) Our evaluations over time have identified numerous examples such as these.

As a result of such practices, DOD records showed that, as of September 1993, it had about \$36.3 billion of inventory on hand that was not needed on hand to support DOD's war reserve or peacetime operating requirements. This excess is the result of a culture that believes it is better to overbuy items than to manage with just the amount of stock needed. This culture has been slow to adopt more efficient management practices, technologies, and logistics systems. For these reasons, we and the Office of Management and Budget have identified DOD's inventory management as one of 18 areas being of "high risk" to fraud, waste, abuse, and mismanagement.

Defense Industrial Base

In response to declining requirements and budgets, the defense industry is attempting to restructure and consolidate. Recent mergers, such as the one between Lockheed and Martin Marietta, are evidence of the industry's efforts. To encourage orderly

⁹Air Force Logistics: Improved Backorder Validation Procedures Will Save Millions (GAO/NSIAD-94-103, Apr. 20, 1994).

downsizing of the defense industrial base, the Congress has enacted legislation that permits the government to assume a portion of the restructuring costs incurred by industry if there are overall savings to the government.

Although the changes are expected to result in cost savings, excess capacity will continue to exist, and this translates into higher weapons costs. To illustrate, let me refer to the Navy's shipbuilding industrial base. The shipbuilding industrial base consists of 19 shipyards that have the capability to construct vessels that are more than 400 feet in length. Of these 19 shipyards, 6 build more than 90 percent of the Navy's ships. During the early 1980s, these six major shipyards maintained robust production lines as the Navy sought to achieve a 600-ship fleet. The end of the Cold War, however, significantly reduced the Navy's shipbuilding requirements. Navy plans call for a fleet of about 350 ships. This has resulted in the six major shipbuilders' having roughly three times the industrial base capacity needed to meet planned Navy shipbuilding requirements.

The Navy's present strategy for managing its shipbuilding program hinders the downsizing of the shipbuilding industry. Instead of awarding contracts competitively, the Navy, under a costly strategy, spreads shipbuilding awards among the six major shipyards. In some cases, such as with the DDG-51 destroyer and SSN-688 submarine programs, contract awards were split between yards. Also, in order to maintain two nuclear capable shipyards, last year, the Navy asked Congress to fund a new nuclear aircraft carrier earlier than needed, and this year, is asking Congress to approve a third Seawolf submarine. The spreading of awards significantly increases Navy shipbuilding costs--primarily because of construction inefficiencies and increased contractor and government overhead costs--and excess capacity continues.

Financial Management

Over the past several years, numerous reports by congressional committees, the DOD Inspector General, and us have criticized DOD for its inability to provide adequate stewardship over taxpayers' monies. Further, the military services have thus far been incapable of complying with the Chief Financial Officers Act and the Government Management Reform Act, which together require DOD organizations to produce auditable financial statements--a routine responsibility that we expect private sector firms to fulfill as a matter of course. In presenting the fiscal year 1995 budget, the Secretary of Defense said, "(O)ur financial management...is a mess, and it is costing us money we desperately need." We agree with that assessment and have recently identified DOD's financial management as a high-risk area.¹⁰

¹⁰High-Risk Series: An Overview (GAO/HR-95-1, Feb. 1995).

DOD is accountable for over \$1 trillion in assets and estimated outlays of \$272 billion in fiscal year 1995--approximately 50 percent of the federal government's discretionary spending. However, the severe shortcomings in DOD's financial operations preclude DOD from providing meaningful and reliable financial information on the results of operations. Such information is critical for DOD management to make informed decisions and measure performance. Reliable information is also imperative for the Congress to exercise oversight over DOD's operations.

Many of the financial management problems confronting DOD today are not new. They are long-standing problems that have not been effectively dealt with. For example, over the past 15 years, we have issued over a dozen reports related to DOD's disbursement problems. In October 1994, we reported that DOD's records contained at least \$24.8 billion of problem disbursements as of June 1994.¹¹ As of February 1995, the amount of problem disbursement transactions had increased to \$33 billion. This is about a one-third increase in problem disbursement transactions over an 8-month period. We know that many of these problem transactions cause inaccurate payments to be made to contractors. During a 6-month period in fiscal year 1993, contractors returned \$751 million to the government, and in fiscal year 1994, they returned \$957 million, most of which appears to have been overpayments detected by the contractors.

Further, ineffective financial management systems have impeded DOD's efforts to reduce the cost of operations. The Defense Business Operations Fund provides a mechanism through which DOD can adopt a business-like approach for identifying and reducing its operating costs. However, to date DOD has not achieved this objective. As discussed in our March 1995 report,¹² DOD's ability to properly manage the fund continues to be hindered because of DOD's inability to (1) manage cash, (2) enhance financial systems, and (3) produce accurate financial reports on the results of operations. Systems that produce credible cost data are essential for the successful operation of the fund. Accurate cost data are also critical to develop systematic means of reducing the cost of operations.

Until DOD's antiquated financial systems are fixed, the infrastructure cost of maintaining multiple systems for the same purpose will continue, and decisionmakers will continue to receive inaccurate and unreliable information. Every dollar that DOD wastes due to ineffective management of its financial

¹¹Financial Management: Status of Defense Efforts to Correct Disbursement Problems (GAO/AIMD-95-7, Oct. 5, 1994).

¹²Defense Business Operations Fund: Management Issues Challenge Fund Implementation (GAO/AIMD-95-79, Mar. 1, 1995).

operations is one less dollar DOD will have to finance other requirements.

It should also be recognized that many of the financial management weaknesses we have noted are not due solely to inadequate systems. Rather, they result from the improper or insufficient use of current systems and a failure to follow established internal control procedures. Thus, new systems alone will not solve DOD's financial management problems. For example, if data in the current systems are not corrected, this inaccurate data will simply be transferred to any new systems. Clearly, DOD will have to upgrade its financial management practices and place greater emphasis on complying with internal controls if efforts being spent on developing new systems are to translate into real improvements to financial operations.

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Mr. Chairman, this concludes my prepared statement. I will be glad to answer any questions you or Members of the Committee may have.

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